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Nos. 400 and 444

In the Supreme Court of the United States

OCTOBER TERM, 1940

CONSOLIDATED ROCK PRODUCTS CO., AND EDWARD E. HEATH ET AL., CONSTITUTING THE PREFERRED STOCKHOLDERS COMMITTEE OF CONSOLIDATED ROCK PRODUCTS CO., PETITIONERS

v.

E. FLOYD DU BOIS

T. P. BARCLAY ET AL., COMPOSING THE UNION ROCK COMPANY, BONDHOLDERS' PROTECTIVE COMMITTEE, ET AL., PETITIONERS

v.

E. FLOYD DU BOIS

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 400

CONSOLIDATED ROCK PRODUCTS CO., AND EDWARD E. HATCH ET AL., COMPOSING THE PREFERRED STOCKHOLDERS COMMITTEE OF CONSOLIDATED ROCK PRODUCTS CO., PETITIONERS

v.

E. BLOIS DU BOIS

No. 444

F. B. BADGLEY ET AL., COMPOSING THE UNION ROCK COMPANY, BONDHOLDERS' PROTECTIVE COMMITTEE ET AL., PETITIONERS

v.

E. BLOIS DU BOIS

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

On June 19, 1940, the Circuit Court of Appeals for the Ninth Circuit reversed an order of the District Court for the Southern District of California confirming a plan of reorganization for Consoli-

dated Rock Products Company (hereinafter called "Consolidated") and its two subsidiaries, Union Rock Company (hereinafter called "Union"), and Consumers Rock and Gravel Company, Inc. (hereinafter called "Consumers"). Two petitions for writs of certiorari have been filed to secure review by this Court of the order of reversal. No. 400 is a petition filed by Consolidated and a committee of its preferred stockholders. No. 444 is a petition filed by two protective committees for Union's and Consumers' bondholders, respectively.

This memorandum is filed on behalf of the Securities and Exchange Commission, as *amicus curiae*, to urge (1) that the petition in No. 444 be granted; and (2) that the petition in No. 400 be granted to the extent that it presents the same question as that presented by the petition in No. 444, but that it be otherwise denied.

OPINIONS BELOW

The District Court rendered no opinion; its findings and conclusions appear at R. 219–265. The opinion of the Circuit Court of Appeals directing reversal of the decree of the District Court (R. 365–380) is not yet reported. An earlier opinion of the Circuit Court of Appeals directing affirmance of the decree of the District Court was withdrawn by the court (R. 364); that opinion is not a part of the record, but it may be found in 107 F. (2d) 96, advance sheets.

JURISDICTION

The decree of the Circuit Court of Appeals was entered on June 19, 1940 (R. 381). The petition for a writ of certiorari in No. 400 was filed on September 6, 1940, and the petition for a writ of certiorari in No. 444 was filed on September 18, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Consolidated, Union and Consumers each filed a petition to reorganize under Section 77B of the Bankruptcy Act. Union and Consumers each has an outstanding issue of bonds, each issue being secured by a mortgage on the properties owned by the issuing company. The District Court found that in the case of neither company are the properties owned by it of a value equal to the face amount of the bonds issued by it, plus accrued interest. It also found that the properties of all three companies are commingled and have long been operated together as a single unit, and that it is necessary and desirable to maintain operations on a unified basis. A ~~simple~~ single plan of reorganization has been filed for all three companies, providing for the organization of a new corporation to acquire the properties of the companies and for the issuance to the bondholders of Union and Consumers, among other things, of a single issue of bonds of the new corporation secured by a mortgage on all of its property.

The only question presented in No. 444 is whether this plan is, as a matter of law, unfair and inequitable solely because the bondholders of each company must share the property securing their bonds with the bondholders of the other company, even though they receive by way of compensation an equivalent interest in the property securing the bonds of the other company.

The same question is presented in No. 400. Petitioners in No. 400, however, seek review of the following additional questions: (1) whether the rule announced by this Court in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, is inapplicable to the present plan of reorganization on the ground that the combined enterprise of Consolidated, Union and Consumers is solvent; and (2) whether, if the rule in the *Los Angeles Lumber* case is applicable, the court below erred in failing to find that the present plan meets the requirements of that rule.[1]

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[1] Petitioners in No. 400 state that there is also presented the question whether a circuit court of appeals can usurp the function of a district court by reversing a conclusion of the district court that a plan of reorganization is fair and equitable. The issue thus sought to be raised is wholly without substance. Petitioners erroneously assume that the conclusion of a district court with respect to a plan is a finding of fact, despite the specific holding by this Court that the conclusion is one of law. *Case* v. *Los Angeles Lumber Products Co., Ltd., supra.* In any event, the appeal in this case was taken under Section 24 (a) of the Bankruptcy Act (11 U. S. C., Sec. 47 (a)). This section, as amended by the Act of June 22, 1938 (c. 575, 52 Stat. 854–855), provides for review of questions of fact as well as of questions of law.

STATUTE INVOLVED

The statute involved is Section 77B (f) of the Bankruptcy Act (11 U. S. C., Sec. 207 (f)), the pertinent portion of which is as follows:

> After hearing such objections as may be made to the plan the judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible * * *.

STATEMENT

1. *REORGANIZATION PROCEEDINGS*

A plan of reorganization for Consolidated, Union, and Consumers was confirmed by the District Court on September 8, 1938 (R. 261–264). On November 4, 1939, the Circuit Court of Appeals rendered an opinion affirming the order of confirmation. After the decision of this Court in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, the court below granted a petition for rehearing and ordered its first opinion withdrawn (R. 363–364). Upon the rehearing, the order of confirmation was reversed.

No useful purpose would be served by setting forth here the facts with reference to the properties and securities of the three companies in reorganization, and with reference to the provisons of the plan of reorganization, since full recitations of these facts are contained in the petitions for certiorari, in the brief in opposition filed by the re-

spondent in No. 400, and in the opinion of the court below.

2. *PARTICIPATION OF THE SECURITIES AND EXCHANGE COMMISSION IN THE CASE*

The Securities and Exchange Commission first appeared in the present case by filing a brief *amicus curiae* upon the rehearing in the court below. After entry of the decree of reversal the Commission filed a notice of appearance in the District Court pursuant to Sections 208 and 276c. (2) of Chapter X of the Bankruptcy Act, as amended (11 U. S. C. Secs. 608, 676c. (2)). The Commission is now participating as a party in the proceeding before the District Court.

In its brief filed in the court below the Commission sought reversal of the order of confirmation, urging that the plan of reorganization failed to meet the requirements of the rule enunciated in *Case* v. *Los Angeles Lumber Products Co., Ltd., supra*. The court below reversed the order of confirmation as requested by the Commission, but it did so, in part at least, upon a ground which the Commission believes to be untenable and which, if allowed to stand, may not only seriously impede the reorganization of the three companies involved in this case but may also embarrass the reorganization of many other companies which have filed petitions to reorganize under the Bankruptcy Act. Because of the advisory functions which the Commission performs in reorganizations under Chap-

ter X, as well as because of its participation in the present proceeding, the Commission has a substantial interest in having the Court review this aspect of the decision below.

ARGUMENT

Upon the rehearing in the court below, the respondent and the Commission contended that the order of confirmation should be reversed because the plan of reorganization failed to meet the requirements of the rule enunciated in *Case* v. *Los Angeles Lumber Products Co., Ltd., supra*. The basis of the contention was that the plan did not provide fully compensatory treatment for the bondholders of Union and Consumers to the extent of the value of the assets subject to their claims, and yet allowed participation in those assets by the preferred stockholders of Consolidated whose position was junior to that of the bondholders. The court below held that the findings of the District Court were inadequate to allow final disposition of this contention, since the findings failed to show the value of the properties subject to the lien of the bonds issued by Union and Consumers, the value of any assets of Consolidated and the value of disputed claims, aggregating $5,000,000, which Union and Consumers had against Consolidated (R. 373–374).

The court might have stopped at this point and remanded the case to the District Court for further

findings. Instead of so doing, however, it simply observed (R. 374) that "since the plan proposed, we think, is unfair as a matter of law for reasons hereafter stated; we assume that both matters mentioned will be satisfactorily disposed of upon remand of the cause."

The reasons why the court believed the plan to be unfair as a matter of law were then stated by it in the following words (R. 377):

> The trial court found that the property of Union covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Union, yet the Union bondholders are deprived of their right to full priority against Union's assets, since Consumers' bondholders and debtor's preferred stockholders are given an interest in Union's property. Likewise, the trial court found that the property of Consumers covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Consumers, yet Consumers' bondholders are deprived of their right to full priority against Consumers' assets, since Union bondholders and debtor's preferred stockholders are given an interest in Consumers' property. Exactly in point, as to facts, is *Case* v. *Los Angeles Lumber Co., supra.* Since the order must be reversed on the ground that the bondholders have not been accorded full priority, it is unnecessary to discuss other charges of unfairness in the plan, some of which appear to be sound.

As we understand this portion of the opinion, the court below held that a class of claimants with a lien on particular properties must receive fully compensatory treatment out of those properties and may not *as a matter of law* receive less than fully compensatory treatment out of those properties even though this class of claimants may be adequately compensated with an interest in properties subject to the lien of another class of claimants.[2] This holding, unless reversed by this Court,

[2] This portion of the opinion is not entirely clear in so far as it declares the plan to be unfair to the bondholders because the preferred stockholders of Consolidated are given an interest in the assets securing the bonds. The court may have meant simply that the participation of the preferred stockholders in the plan was unfair to the bondholders because the bondholders had not received full priority; it may have meant, on the other hand, that the preferred stockholders should not have been allowed to share in the particular assets securing the bonds because the bondholders had not received fully compensatory treatment out of those assets.

But whatever the court may have meant by its reference to the preferred stockholders, it plainly intended to announce the principle of law stated in the text in so far as it held the plan unfair as a matter of law because each group of bondholders was required to share its security with the other group of bondholders. No other construction can be given to the words (R. 377) that "the Union bondholders are deprived of their right to full priority against Union's assets, since Consumers' bondholders * * * are given an interest in Union's property" and that "Consumers' bondholders are deprived of their right to full priority against Consumers' assets, since Union bondholders * * * are given an interest in Consumers' property." That the mention of the interest given to each group of bondholders in the assets of the other group was not inadvertent is shown by

will necessarily control all further steps in the present reorganization proceeding.[3] Consequently, it is reviewable by this Court independently of other grounds upon which the order of reversal may be sustained.[4]

1. The principle of law thus announced by the court below presents a question of substantial public importance which has not been, but should be, decided by this Court. The question arises in many industrial and railroad reorganizations where it is necessary or desirable to maintain uni-

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the fact that the court below denied a motion, joined in by all of the parties, to modify this paragraph of the opinion so as to delete references to the interest given to each group of bondholders in the property securing the claims of the other group of bondholders. (R. 382–383.)

[3] We do not express an opinion as to whether it is either necessary or desirable, in the circumstances of this case, that the properties continue to be operated as a unit and that the separate liens be displaced. The Master (R. 147–148) and the District Court (R. 261, 241) so found, and the Circuit Court of Appeals did not question this finding.

[4] The denial of these petitions would result in the issuance of a mandate by the court below remanding the case to the District Court for further proceedings in accordance with the opinion of the court below. See Rule 28 of the Rules of the Circuit Court of Appeals for the Ninth Circuit. The District Court would thereafter be bound to conduct further proceedings in accordance with the principle of law announced by the court below. Consequently, although we believe the order of reversal to be correct for other reasons (see pp. 15–18, *infra*), this ground of decision may be separately reviewed. If certiorari be granted, we shall ask this Court to direct modification of the decree of the Circuit Court of Appeals insofar as it requires conformity to the principle of law concerning which we urge review.

fied operation of properties mortgaged to secure separate bond issues and where considerations of feasibility require a simplified capital structure. The problem may also arise, even in the absence of liens, with respect to the treatment of the securities of any two or more corporations the properties of which it is necessary or desirable to combine in a single reorganized corporation.

In the reorganization of traction companies and railroads it is common practice to give to separate classes of security holders, in exchange for securities with liens on portions of the railway properties, securities of the same class or classes representing claims against the enterprise as a whole. Decisions sustaining such plans of reorganization are in principle directly opposed to the holding of the court below.

In *In re United Railways and Electric Company*, 11 F. Supp. 717 (D. Md.), for example, nine different security issues, each secured by a mortgage (in almost every case a divisional lien), were supplanted by a single issue of debentures and an issue of preferred stock, both of which were securities of a single corporation holding title to all of the former divisional properties. The District Court stated (p. 720):

> There had been outstanding for many years 12 issues of securities, constituting the capitalization of the company. Of these, five were divisional bonds, and two were Maryland Electric Company bonds, which

> were substantially divisional bonds. Each one of these divisional bonds covered a railway which was originally an independent unit, a self-contained railway, but through the later consolidations this independent character was completely destroyed. The identity of the respective assets of each railway became lost and, therefore, it became absolutely essential to disregard the various divisions in the present reorganization, in so far as different securities were concerned, and simply to proportion, as nearly as possible, the actual values that now adhere to the respective parts, as represented by the old securities. Thus, under the reorganization, nine different mortgages with their respective securities have been supplanted by the issue of (1) debentures and (2) preferred stock. * * *

A typical railroad case is *Jameson* v. *Guaranty Trust Company of New York,* 20 F. (2d) 808 (C. C. A. 7th), certiorari denied, 275 U. S. 569. That was an equity receivership in which the District Court and the Circuit Court of Appeals approved a reorganization plan providing that the holders of outstanding bond issues, each secured by a lien on a particular portion of the company's property, should participate equally in two new bond issues, a first mortgage and a second mortgage, each covering all of the properties by which the old bond issues had previously been separately secured.

More recently, in reports under Section 77 of the Bankruptcy Act (11 U. S. C. § 205), the Interstate Commerce Commission has approved as fair and equitable a number of plans of reorganization for railroads in which separate classes of divisional lienors were given general system securities of the same classes in exchange for their claims.[5] Several of these reports were filed subsequent to the decision of this Court in *Case* v. *Los Angeles Lumber Products Co., Ltd., supra.*

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[5] See *Missouri-Pacific R. R. Co. Reorganization*, 239 I. C. C. 7, 240 I. C. C. 15; *Chicago and North Western Railway Co. Reorganization*, 236 I. C. C. 575, 239 I. C. C. 613, approved by the District Court for the Northern District of Illinois on September 11, 1940, C. C. H. Bankruptcy Service, Par. 52666; *Chicago, Milwaukee, St. Paul and Pacific R. Co. Reorganization*, 239 I. C. C. 485, 240 I. C. C. 257; *Savannah & Atlanta Railway Reorganization*, 224 I. C. C. 197, approved by the District Court for the Southern District of Georgia on February 5, 1938, C. C. H. Bankruptcy Service, Par. 51448, and confirmed on December 12, 1938; *Spokane International Railway Company Reorganization*, 228 I. C. C. 387, 233 I. C. C. 157, approved by the District Court for the Eastern District of Washington on March 2, 1940, C. C. H. Bankruptcy Service, Par. 52567, and confirmed on August 17, 1940; *Erie R. Co. Reorganization*, 239 I. C. C. 653, 240 I. C. C. 469; *Western Pac. R. Co. Reorganization*, 230 I. C. C. 61, 233 I. C. C. 409, 236 I. C. C. 1, approved by the District Court for the Northern District of California on August 15, 1940, C. C. H. Bankruptcy Service, Par. 52665; *New York, N. H. & H. R. Co. Reorganization*, 239 I. C. C. 337; *Akron, C. & Y. Ry. Co. and Northern O. Ry. Co. Reorganization*, 228 I. C. C. 645; *St. Louis-S. F. Ry. Co. Reorganization*, 240 I. C. C. 383; *Chicago, Rock Island & Pacific Railway Company*, Finance Docket No. 10028 (examiner's report on plan filed on September 22, 1939).

Reorganization in some types of cases might be impossible under the holding of the court below. The reorganization provisions of the Bankruptcy Act,[6] and comparable provisions of other statutes,[7] require that a plan of reorganization be feasible as well as fair and equitable. If the holding of the court below is correct, a plan of reorganization which fails to preserve priorities of separate lienors against the properties securing their respective claims cannot be fair. Yet in many cases any plan attempting to preserve separate liens would necessitate so complicated a capital structure that it would not be feasible. Consequently, in some cases, no plan of reorganization complying with the statutory standards would be possible.

We believe it plain that the *Los Angeles Lumber* decision does not require that a plan be held unfair and inequitable, as a matter of law, where bondholders receive less than complete priority

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[6] Sec. 77 (e), 11 U. S. C. § 205 (e); Sec. 77B (f), 11 U. S. C. § 207 (f); Chapter X, Secs. 174 and 221 (2), 11 U. S. C. §§ 574 and 621 (a); Chapter XI, Sec. 366 (3), 11 U. S. C. § 766 (d); Chapter XII, Sec. 472 (3), 11 U. S. C. § 872 (3); Chapter XIII, Sec. 656 (3), 11 U. S. C. § 1056 (3).

[7] Section 11 (e), of the Public Utility Holding Company Act of 1935, 15 U. S. C. § 79k (e), authorizes the Securities and Exchange Commission to approve, and to take steps to enforce, plans of reorganization of registered public-utility holding companies or their subsidiaries which must be both "fair and equitable" and "necessary to effectuate the provisions of subsection (b)". Among other things, Sec. 11 (b) requires the Commission to direct each registered holding company and subsidiary thereof to insure that its corporate structure is not unduly or unnecessarily complicated.

with respect to the assets on which they have a lien, provided that they are adequately compensated for the loss of their prior claims by an interest in other assets. Obviously, lienors may have to surrender their priority to, or share it with, persons who contribute new funds to the enterprise; in such case their compensation will consist in the acquisition of an interest in the new funds. The present situation is similar, except that the contribution is in property rather than in money. Consumers' bondholders share their priority with persons who contribute property necessary for the success of the enterprise as a whole, namely, the Union bondholders; the converse is equally true. So long as each group shares on an equitable basis in the securities of the combined enterprise, the plan of reorganization satisfies the requirements of the *Los Angeles Lumber* rule.

2. The question just discussed is the only one presented in No. 444. We urge, therefore, that the petition in No. 444 be granted. The petition in No. 400, however, seeks to raise additional questions which, in our opinion, do not warrant review by this Court. Consequently, we urge that in No. 400 the petition be granted only to the extent that it raises the same question as that presented in No. 444.

A. The first of the additional questions sought to be raised in No. 400 is whether the rule of the *Los Angeles Lumber* case is inapplicable to the present reorganization on the ground that the combined en-

terprise of Consolidated, Union, and Consumer
solvent. Although the court below held that
rule was applicable to a solvent Debtor, conside
tion of the question by this Court at the pres
time would be premature, since, as the court be
held, the findings of the District Court are ina
quate to determine the solvency of the enterpr
and, consequently, the extent, if any, of the ri
of the preferred stockholders to be recognized
the plan of reorganization (R. 379–380). T
court below assumed that, upon remand of
case, further findings with respect to the value
the companies' properties would be made (R. 37
it did not rule that, if these further findings sh
that there is an equity for the preferred sto
holders, they may not participate in the reorgani
tion. Consequently, at this stage of the proce
ings, the only issue which could be presented
this Court is whether the court below erred in c
cluding that the findings of the District Court w
inadequate. This issue is obviously not one call
for review.

Furthermore, the proposition that the full p
ority rule of the *Los Angeles Lumber* case does
apply to a solvent enterprise is so manifestly wi
out substance as not to warrant consideration
this Court. Petitioners' contention is, in eff
that while creditors' rights must be fully protec
in the case of an insolvent debtor, they need not

regarded with the same solicitude if a debtor is not insolvent. This contention misconceives the plain meaning and logic of the *Los Angeles Lumber* decision. It is true that, if the corporation is insolvent, the creditors' priorities necessitate the exclusion of stockholders, while, if the corporation is solvent, stockholders may be entitled to participate in the reorganization. But the exclusion of stockholders of an insolvent corporation is required because no equity remains for them after full satisfaction of creditors; the inclusion of stockholders of a solvent corporation is permitted because some equity remains, after full satisfaction of creditors, justifying their participation. The difference is factual, not legal, for creditors of a solvent corporation clearly have no less right to priority to the full extent of their claims than do creditors of an insolvent corporation.

The lower federal courts are all in agreement with the decision below in this case that the rule of strict priority applies to solvent as well as to insolvent corporations. See *In re Utilities Power & Light Corporation,* 29 F. Supp. 763 (N. D. Ill.), appeal dismissed by the Circuit Court of Appeals for the Seventh Circuit, March 9, 1940; *In re Chicago Great Western Railroad Co.,* 29 F. Supp. 149 (N. D. Ill.); *In re National Food Products Corporation,* 23 F. Supp. 979 (D. Md.). Agreement with this view is also implicit in decisions affirming

orders which had confirmed plans of reorganization in *In re Porto Rican American Tobacco Company,* 112 F. (2d) 655 (C. C. A. 2nd) and in *In the Matter of Oscar Nebel Co., Inc.* (C. C. A. 3d), decided July 8, 1940, but not reported.

B. The second additional question sought to be raised by petitioners in No. 400 is whether, assuming the *Los Angeles Lumber* decision to be applicable, the court below erred in failing to find that the plan of reorganization complied with the requirements of that decision. Even on the basis of the inadequate findings of the District Court, we believe it plain that, under the plan, the bondholders of Union and Consumers receive securities of a value less than the asset value of their claims and, therefore, that they are not accorded the full priority which the *Los Angeles Lumber* decision requires to be given them before stockholders may participate in the reorganization. But whether this be so or not is immaterial for present purposes since, as we have pointed out, the court below did not rule on the question of whether the preferred stockholders of Consolidated should be allowed to participate in the reorganization at all and, if allowed to participate, whether or not the provision made for them in the plan was unfair to the bondholders. To the contrary, it held that it could not decide this question because

the findings of the District Court were inadequate both with respect to the value of the properties securing the Union and Consumers bonds and with respect to the value of the claims of these companies against Consolidated.[8] Consequently, the only question which could properly be presented to this Court on this aspect of the case would be whether the court below erred in holding that the findings of the District Court were insufficient. This question is plainly not one with which this Court should concern itself.

CONCLUSION

We urge that the petition in No. 444 be granted, and that the petition in No. 400 be granted to the extent that it raises the same question as that pre-

[8] The petitioner suggests that a question is presented as to the applicability of the *Los Angeles Lumber* case to a situation where stockholders are allowed to participate because of the compromise of disputed claims, i. e., the claims of Union and Consumers against Consolidated. With reference to the asserted compromise, the record simply shows that Union and Consumers had claims against Consolidated which were disputed both as to validity and amount, and that under the plan of reorganization the claims would be eliminated. The court below held that the findings of the District Court were insufficient to determine the validity or value of the claims and for this reason, among others, held that, until the claims were settled either voluntarily or by litigation, it could not determine the fairness of any plan of reorganization. Consequently, there cannot now be presented to this Court the question of the effect of the asserted compromise.

sented by the petition in No. 444, but that it be otherwise denied.

Respectfully submitted.

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